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IN THE

Supreme Court of the United States

OCTOBER TERM, 1949.

Nos. 695, 696

BENTLY S. HANDWORK, RALPH C. BOOZER, AND PHILIP W. LOTZ, INDIVIDUALLY AND AS TRUSTEES, ETC.,
Petitioners,

vs.

HORACE A. YOUNG, AS TRUSTEE IN BANKRUPTCY OF THE ESTATE OF GEORGE R. JOSLYN, BANKRUPT,
Respondent.

REPLY BRIEF OF PETITIONERS IN SUPPORT OF PETITION FOR CERTIORARI.

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REPLY BRIEF OF PETITIONERS IN SUPPORT OF PETITION FOR CERTIORARI.

MAY IT PLEASE THE COURT:

The petitioners, by their attorneys, present herewith their reply brief to the brief of Horace A. Young in opposition to the petition for writ of certiorari to the United States Court of Appeals for the Seventh Circuit heretofore filed herein, and state as follows:

I.

The Respondent Attempts to Prejudice This Court Against Petitioners.

The respondent, in seeking to divert this Court from the questions presented by the petition for certiorari, and for the obvious purpose of creating confusion and preju-

dice, makes irresponsible and unsupported charges of fraud (Res. Br. 2) founded upon matters expunged and stricken from the record by the District Court (R. 201). The charges are irrelevant in that this plenary suit was filed against petitioners who are trustees under trusts created by persons other than the bankrupt, seeking a recovery which could not be obtained under Illinois law. Since the Federal Court was bound to follow the Illinois decisions, there could be no basis here for a charge of fraud in failing to schedule that which was not property in the first instance. The charges of fraud would be just as inappropriate if made against the Judge of the District Court who decided that the respondent's action was barred by Section 49 of the Illinois Chancery Act and that the interests in the trust estates were therefore not property within the meaning of Section 70 of the Bankruptcy Act. These charges are irrelevant for the further reason that they are directed against the bankrupt who is not a party to this proceeding. Had respondent made the bankrupt a party his presence in this case would have destroyed the diversity jurisdiction upon which the respondent has relied in seeking to obtain a different ruling from that obtainable in the State Courts of Illinois.

II.

The Judgment of the Court of Appeals Respecting Diversity Jurisdiction Is Final and Appealable. The Judgment of the Court of Appeals Respecting Section 49 of the Illinois Chancery Act Decided a Question Fundamental to the Further Conduct of This Case and Is a Proper Subject for Review on a Petition for Certiorari.

The respondent argues that the judgments of the Court of Appeals are not final and that certiorari should be denied upon that ground (Res. Br. 3-5). It should be pointed out, however, that the judgment in No. 696 in this Court

affirming the District Court in so far as federal diversity jurisdiction is concerned is a final judgment (R. 251). As we have further shown, with respect to No. 695, the Court of Appeals in holding that Section 49 of the Illinois Chancery Act did not bar the respondent's action decided a question fundamental to the further conduct of this case. *Land* v. *Dollar,* 330 U. S. 731, 734; *Larson* v. *Domestic and Foreign Corp.,* 337 U. S. 682, 685. The Court of Appeals also stated that it was ruling upon "the merits" of this case (R. 237-238). If the present petition for certiorari had not been filed, the respondent would certainly have argued in the District Court upon the remandment of this case that the judgment in case No. 695 had been acquiesced in and had established the law of the case which the District Court was bound to follow. It is even now argued that the Court of Appeals' opinion is the "law of the case" and it is to be anticipated that the respondent will seek to employ this argument to overcome any other issues not presented in the motion to dismiss respondent's complaint (Res. Br. 4).

Indeed, in seeking to extend the judgment of the Court of Appeals, the respondent repeatedly refers to the Joslyn Family Trusts as "non-spendthrift trusts" (Res. Br. 5, 14, 18 and 19), although the District Court did not hold that these trusts were non-spendthrift.

III.

The Sole Ground of Federal Jurisdiction in This Case Is Diversity of Citizenship.

Respondent in his brief in this Court (for the first time in this proceeding) alleges a ground of federal jurisdiction other than "diversity of citizenship". In his brief (Res. Br. 7) it is alleged that the District Court "also had juris-

diction" under Section 70(e) (3) (11 U. S. C., Ch. 7, par. 110(e) (3)). This section refers solely to voidable transfers and is obviously inapplicable. That section has never heretofore been referred to in this case. In his complaint the respondent invoked federal jurisdiction with the following allegation (R. 2):

> "There is, therefore, diversity of citizenship between the parties to this action. (and)
>
> "2. The matter in controversy exceeds, exclusive of interest and costs, the sum of $3,000, and is of a civil nature."

As we have shown, the respondent was entitled to no relief under Illinois law if this case were brought in the Illinois courts. Therefore, in this diversity case, the Federal Court should not grant relief.

IV.

Hummel v. Cardwell, 390 Ill. 526, Held That Trust Interests Such as Are Involved Here May Not be Recovered in a Plenary Suit by a Creditor or Bankruptcy Trustee. No Illinois or Federal Decisions Have Held Otherwise.

The respondent has misstated and misconstrued the case of *Hummel* v. *Cardwell* in his presentation of that case to this Court (Res. Br. 14-15). As is demonstrated from the quotation of that case included in our brief (Pet. Br. 13-14), the *Hummel* case clearly held that trust interests such as are here involved are not transferable and may not be recovered by a bankruptcy trustee in a plenary suit in the Illinois State Courts.

The principal difference between that case and this is that in the present case the respondent's action was filed in the Federal District Court on the ground of diversity of citizenship.

The respondent is clearly erroneous in his statement that the interest of the beneficiary here is transferable property under Illinois law. He referes to cases which he cited to the Court of Appeals and which that court purported to follow in its erroneous decision (Res. Br. 15). We shall refer to those decisions briefly:

The Merchants Loan and Trust Co. v. *Patterson,* 308 Ill. 519, involved title to real property where the grantors named themselves as beneficiaries under a deed in trust for years. The grantors were beneficiaries for years and also the remaindermen. Section 49 of the Illinois Chancery Act which was held by the District Court to bar the respondent's action here (R. 203) was not involved since the Illinois statute only protects trust interests created by some person other than the beneficiary (as in the present case).

In *Hiss* v. *Hiss,* 228 Ill. 414, the life beneficiary was also the remainderman and therefore was both the beneficial and legal owner. No reference was made there to Section 49 of the Illinois Chancery Act.

In *Binns* v. *LaForge,* 191 Ill. 598, the Illinois Supreme Court applied the doctrine of estoppel where a beneficiary *in possession* had secured credit in consideration of an assignment of a trust interest and then sought to renege.

Blair v. *Linn,* 274 Ill. App. 23, was not a contested proceeding since both sides of the controversy were interested in obtaining court approval of an abortive assignment in order to effect an income tax saving and the life tenant was held entitled to relinquish his interest in favor of his children who were the remaindermen.

In *Blair* v. *Commissioner,* 300 U. S. 5, this Court followed the *Blair* v. *Linn* decision as the expression of the highest court of this state upon the property questions there involved, although the Illinois Supreme Court undoubtedly would not have acquiesced in the Appellate Court's opinion

as pointed out in the Appellate Court dissent which cited *Hopkinson* v. *Swaim*, 284 Ill. 11.

As we pointed out in our petition for certiorari, the Illinois Supreme Court in that case held that where trust income could not be reached by creditors, it could *not* be voluntarily transferred by a life beneficiary (Pet. for Cert., p. 15).

The only question involved in *Brown* v. *Fletcher*, 235 U. S. 589, was whether an assignee of a portion of the corpus of a New York trust estate could maintain an action in the Federal Court in New York.

Thus, the respondent, while arguing that the interest of the beneficiary is transferable both under Illinois law and Federal law, cites no authority whatever for his erroneous contention. His reliance upon *Hummel* v. *Cardwell*, 390 Ill. 526, as authority for holding such a trust interest as is here involved to be transferable, is a most brazen attempt to mislead this Court, as it is obvious from a reading of the *Hummel* v. *Cardwell* case that that decision is in direct conflict with the result reached here by the Court of Appeals.

The numerous cases involving stock exchange seats, liquor licenses, insurance policies, Indian headrights, etc., referred to by respondent (Res. Br. 20-21) are not relevant to this controversy, as has already been shown in our brief to this Court (Pet. Br. 24). The distinction was also brought out in *In re Whitney*, 113 F. 2d 426 (C. C. A. 2), where the Court said at page 428:

> "The interest of the beneficiary of a trust who becomes a bankrupt is not treated as an ordinary chose in action and regarded as in the constructive possession of the bankruptcy court, but the trustee who holds the *res* on behalf of the bankrupt is classed as an adverse claimant. The interest of a *cestui* in a trust is not like his interest in a stock exchange seat

(*In re Hoey*, 2 Cir., 290 F. 116) or in a claim against the state (*In re Weston*, 2 Cir., 68 F. 2d 913, 98 A. L. R. 319), * * *."

V.

The Federal Court in a Diversity Action by a Bankruptcy Trustee Should Follow the Local Property Law of the State Where It Sits.

The respondent does not deny that State exemption statutes and property laws vary in the several States, but argues, in effect, that since the federal constitution authorizes uniform laws of bankruptcy, that these State statutes and rules of property should yield to such uniformity where a bankruptcy trustee sues on behalf of creditors (Res. Br. 22). That simply is not the law. *Hanover National Bank* v. *Moyses*, 186 U. S. 181, 190; *Vanston Bondholders Protective Committee* v. *Green*, 329 U. S. 156, 172; *Eaton* v. *Boston Trust Co.*, 240 U. S. 427, 429.

Referring specifically to trust interests it is stated in Collier on Bankruptcy (14th Ed), Vol. 4, p. 1149:

> "Whether the bankrupt's interest as a *cestui que* trust was, at the time of bankruptcy, assignable or transferable, or subject to attachment, seizure or judicial sale, are matters generally to be determined by the law of the state where the trust has its situs." (Underlining added.)

The trust involved in *Medwedeff* v. *Fisher* (Md. 1941), 17 A. 2d 141, was held not to be a spendthrift trust under Maryland law and the interest of the bankrupt in the trust was held to be subject to bankruptcy administration. The same trust interests in Illinois or Missouri may not be recovered by a bankruptcy trustee. *Jones* v. *Harrison*, 7 F. 2d 461 (C. C. A. 8), cert. den. 270 U. S. 652.

The respondent does not deny that the ruling of the Court of Appeals here is directly contrary to the holding of the Illinois Supreme Court in *Hummel* v. *Cardwell*, 390 Ill. 526. Instead he refers to the relevant part of that

opinion as *dictum* and seeks to subject the Illinois statute (Section 49) and Illinois decisions to a federal law because in this diversity action the plaintiff was a bankruptcy trustee. There is no question here of a conflict between the federal bankruptcy act and the Illinois statutes and decisions. The only question is this: May a federal court in a diversity case refuse to apply a state statute which the state court has held to bar the plaintiff's action?

Respondent argues that our petition for certiorari would substitute 48 different rules of property (Res. Br. 22). It is true that the property recoverable by a bankruptcy trustee varies in each of the 48 states depending upon the states' exemption statutes and rules of property, for the federal congress has never authorized a uniform exemption law nor provided for the overruling of state rules of property.

But respondent by asserting a right in the federal court in a diversity case not available in the state courts would impose two separate property rules in each of the states or 96 rules of property in the 48 states. The separate rules in each of the states would depend solely upon the question of whether the plaintiff's action had been filed in the state court or in the federal court (on the ground of a diversity of citizenship).

No federal statutes or decisions warrant such a departure from *Erie* v. *Tompkins*.

Nor can it be argued that the Bankruptcy Act was intended to make uniform the property law of the 48 states. It was only intended that the federal courts in diversity cases should apply the existing property law of the states where they sit—as the District Court did in this case—but as the Court of Appeals refused to do.*

* The same Court of Appeals had held that state property law was binding upon it in a diversity case. See *De Korwin* v. *First National Bank of Chicago*, 179 F. 2d 347 (C. A. 7).

The respondent takes the position in his brief that the mere fact that the plaintiff brings this action as a bankruptcy trustee makes the entire subject of this litigation a federal question (Res. Br. 22-28). From this position he appears to arrive at the erroneous conclusion that this is not a diversity case after all.

But, as we have shown, the sole ground alleged by the plaintiff for federal jurisdiction is a diversity of citizenship. His right to maintain his action in the federal court *upon that ground* has been sustained. Federal jurisdiction upon any other ground has never been urged heretofore. Although the respondent is now endeavoring to change the entire theory of his case, he is bound by rules applicable in diversity cases, namely, that the federal courts in such cases will apply the substantive law of the states where they sit including the states' property law.

If this Court has any doubt as to whether the Illinois Supreme Court would hold the interests in the Joslyn Family Trusts to be subject to levy and sale or capable of transfer (while yet in the possession of the petitioners as trustees of the Joslyn Family Trusts) then it is submitted that there is a question of Illinois property law which should be decided by the Illinois Courts in an action for declaratory judgment or similar proceeding. This was the procedure recommended in *Mangus* v. *Miller,* 317 U. S, 178, where under the farmer-debtor provisions of the Bankruptcy Act, this Court questioned the property law of the State of Utah.

In view of the respondent's erroneous presentation of this case and his inaccurate interpretation of the applicable decisions, it follows that the conclusions reached in his brief are wrong.

Conclusion.

WHEREFORE, petitioners pray that this Court will grant a writ of certiorari to review the judgments of the United States Court of Appeals for the Seventh Circuit in order to reverse the judgments entered therein.

BENTLY S. HANDWORK, RALPH C. BOOZER, and PHILIP W. LOTZ, Individually and as Trustees, Etc.,

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